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GENERAL ACCOUNTING OFFICE WASHINGTON DC
FURTHER DISCUSSION REGARDING RECOMMENDATIONS CONCERNING LOGISTI--ETC(U)
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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

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June 25, 1982

The Honorable Caspar W. Weinberger
The Secretary of Defense

Attention: Director, GAO Affairs

Dear Mr. Secretary:

As my January 29, 1982, letter indicates, several of the positions taken by DOD in response to the 15 recommendations listed in our January 21, 1981, letter deserve further discussion. The purpose of this letter is to bring these to your attention for additional consideration as you strive for more efficient management of DOD resources.

We realize that considerable progress has been made and much more is anticipated. Your letters of February 11, March 6, and December 2, 1981, attest to this. More recently, your fiscal year 1983 budget submission identified projected savings and cost avoidances of over \$20 billion due to efficiencies anticipated in the acquisition and operations areas. As you know, we are in the process of examining such savings and will keep you advised of the progress of that work.

Regarding our 15 recommendations concerning logistical operations, major weapons acquisition, and manpower issues, we are generally pleased by the actions being taken or planned for the future. We realize that some of our proposals have since been overtaken by time or events. However, as summarized below, we still believe there are opportunities to realize savings in several areas.

Concerning the logistical support economies proposed in our January 21, 1981, letter, we believe the actions you initiated in regards to consolidating management of consumable items, integrating traffic management activities, effectively using inventories, and considering logistics support in weapon systems design are commendable and we are generally satisfied with them.

→ On other logistical support items we are concerned with the limited actions taken, particularly the issues regarding the need for a single manager for aircraft depot maintenance and consolidation of base support activities. → cont

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We believe that DOD's plans to improve the acquisition of major weapon systems are commendable and agree that there is a good potential for significant savings resulting from the management improvements being initiated. However, the savings projected for some, such as multiyear contracting, may not be as large as anticipated. Also, difficult problems remain such as canceling lower priority programs and controlling cost growth. We also believe that much would be gained by greater attention to, and application of, the management principles contained in Office of Management and Budget Circular A-109 on major system acquisitions.

We and DOD still have major differences on military pay and retirement issues. DOD has generally taken the position that all service members in a particular grade and with the same time in the service should be treated alike, regardless of whether the member serves in a highly technical hard-to-fill occupation or in an easy-to-fill occupation which requires a minimal skill level. We believe that this "across-the-board" approach has not only become very expensive, but it has also served to make skill imbalance problems worse. We also disagree with the DOD view that the current retirement system effectively supports its manpower requirements.

Our position on each issue is presented in detail in the enclosure. We would be glad to discuss these matters with you or your representatives.

Lastly, we are encouraged by your establishment of the Office of Review and Oversight which has audit follow-up as a specific responsibility. This should result in timely implementation of audit findings of the GAO and other audit groups. We support it and will continue to work with DOD on this and other efforts to promote efficiency in DOD management.

Copies of this letter are being sent to the chairmen, House and Senate Committees on Armed Services and Appropriations; the chairman, House Committee on Government Operations; the chairman, Senate Committee on Governmental Affairs; and other interested parties.

Sincerely yours,

Charles A. Bowles

Comptroller General
of the United States

Enclosure

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LOGISTICAL SUPPORT ECONOMIES

1. Consolidate military base support activities

The DOD's recent actions to reduce base operating support costs indicates progress in this important area. These actions include

- establishing the Contract and Interservice Support Division within the Office of the Deputy Assistant Secretary of Defense for Facilities, Environment, and Economic Development,
- establishing a base support services consolidation cost reduction goal of \$10 million per service per year for the Defense Retail Interservicing (DRIS) program for fiscal years 1983-1987, and
- proposing to allow local commanders to apply personnel positions reduced through consolidations to otherwise unfilled requirements.

Nevertheless, more can and should be done to achieve the savings which are available. We believe the current DRIS savings goal of \$10 million per service per year does not sufficiently challenge the services to achieve the potential savings available in this area, and strongly endorse higher savings goals. The current goal represents a 5-year potential savings of \$150 million. However, this amount is only about 1.2 percent of fiscal year 1980 base operating support costs, the last year in which services' base support costs were aggregated. This budget grew from \$11.7 billion in fiscal year 1978 to \$12.9 billion in fiscal year 1980.

Furthermore, we have indications that the commercial Industrial Type Activities (CITA) program is being used in situations where DRIS consolidations would be more cost effective. We believe it is vital that DOD area-wide interservice consolidations be considered before commercial contracting is used. This action will ensure that the most cost effective in-house support method is compared with contracting costs.

Also, as mentioned in our prior reports, we believe the DRIS program can be further strengthened by taking the following steps:

- Assigning full-time personnel to the local DRIS areas to manage interservice consolidation studies,
- authorizing the local DRIS areas to coordinate CITA activities within their areas, and

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--broadening the scope of the DRIS data bank to identify successful actions in local areas which can be applied nationwide.

In addition, it is imperative that the Secretary of Defense and the Secretaries of the individual Services place increased emphasis on the DRIS program to break down the resistance created by the parochial interests of local base commanders.

2. Complete the consolidation of management of consumable items to cut paperwork, inventories, storage and distribution costs

The announced transfer of wholesale inventory management responsibility for 200,000 consumable items from the military services to the Defense Logistics Agency is an important first step in a resolution of the consumables question. The 200,000 items, drawn from the military services on a pro rata basis, will be selected in such a way as to be representative of the total consumables considered for transfer. The results of this initial transfer, including cost savings and supply performance, will be analyzed and used as the basis for a decision on possible transfer of the remaining items.

In view of the considerable controversy surrounding the transfer proposal, we believe the approach chosen by the Department of Defense is sound. We will follow the results of your analysis with great interest.

3. Single management of aircraft depot maintenance offers rich potential for savings

The Aeronautical Depot Maintenance Task Force was established in September 1981 to oversee OSD's continuing efforts towards improving the capability and efficiency of both organic and contracted depot maintenance for aeronautical systems. According to OSD, an important function of this Management Task Force will be to review and approve both individual and joint service programs and to take the necessary followup actions to achieve their goals in this important area. These goals, however, have not been spelled out nor have milestones been established for the completion of specific objectives. We strongly believe that the success of the Task Force is tied to the immediate establishment of program goals and milestones for achieving these goals, and OSD commitment for seeing that actions are taken. If the Task Force is unable to effect the needed changes within a reasonable time, we believe that more drastic action would be warranted. In such a case, DOD should implement the single manager concept without further delay.

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4. Traffic management activities should be further integrated

In connection with the further integration of traffic management activities, you cite three actions taken or underway:

- a. Consolidation of Personal Property Shipping Offices
- b. Consolidation of Export Cargo offering and Booking offices
- c. Consolidation of the Military Sealift Command (MSC) and the Military Traffic Management Command (MTMC)

We are aware that the consolidation of personal property shipping offices has been ongoing for a number of years. Although not related to the single manager concept we envisioned, these actions should certainly result in economies and improved efficiencies.

The two other consolidations do concern the single manager issue. They indicate that DOD is moving forward in considering improvements in the traffic management area. Recent developments, however, indicate that the Armed Services Committees are having some problems with the current plan to consolidate the Military Sealift Command and the Military Traffic Management Command. It appears that it will require a concerted and convincing effort on your part to achieve the full savings available from this consolidation.

5. Use both wholesale and retail inventories more effectively

The specific actions in your December 2, 1981, progress report apply to the three examples we cited. While commendable, these examples were only three in a long series of reports we have issued pointing out deficiencies in the management of wholesale and retail inventories.

We are pleased with the statement that DOD has placed a high priority on focusing attention on this area because much more needs to be done, particularly with respect to increased visibility and management control of assets at the retail level. The inventory managers lose control and in most cases visibility once the material leaves the wholesale system. We are continually finding cases where the inventory manager is buying material to satisfy a need when the same material is in long supply at a retail site.

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Another area that needs attention is the impact of computerization on requirements determination functions. Accounting for the millions of Defense items is a tremendous task. Numerous computer systems have been bought in an effort to account for these items and to maintain visibility over their procurement, use or disposal. A major problem with these systems is that many are old and outdated by new technology. Also, we find much mistrust of the data being produced by these systems on the part of the inventory managers. This has resulted in an unduly large number of manual overrides.

We will continue to evaluate DOD's efforts to improve the management of these inventories.

6. Consider life cycle logistics and backup equipment requirements early in the weapons planning cycle

We agree that the steps being taken under the Department of Defense initiatives to improve the weapon system acquisition process do address logistics considerations and should result in more effective and efficient integrated logistic support planning. However, as we have noted in our past work, logistics considerations have traditionally received a relatively low priority during the acquisition process.

A major thrust of the new initiatives is to shorten acquisition timeframes. We are concerned that the effectiveness of logistics planning will be further reduced if logistics considerations continue to receive low priority under the shortened acquisition timeframes. Therefore, we urge the Department of Defense to ensure that those initiatives relating to logistics receive the necessary management attention and are fully implemented.

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MAJOR PROCUREMENT ECONOMIES

7. Weapon system funding should be consistent and better managed

Weapon system funding

GAO expressed a belief that instability is a most critical issue and that additional unit costs in the magnitude of 10 to 30 percent result from this problem.

In your status report letter of December 2, 1981, you expressed agreement with the GAO recommendations and identified numerous actions directed at improving program stability. A report by DOD's Acquisition Improvement Task Force, released January 25, 1982, states that a major portion of the ultimate success of the acquisition improvement program can be directly related to the degree to which programs are stabilized--- initiative No. 4. The report points out that although some progress has been made, significant problems remain. Some major barriers to achieving stability were identified as:

- Fluctuation of the defense budget.
- Reluctance to cancel major lower priority programs.
- Continuing cost growth and technical problems.

Specific actions underway by DOD to overcome the barriers to stability include realistic budgeting, reinforce and revise policy (DOD Directive 5000.1 and DOD Instruction 5000.2), stabilize highest priority programs, develop more realistic estimates and better inflation estimates, and timely decisionmaking. Success in achieving program stability is also dependent upon effective implementation of several other initiatives, particularly multiyear procurements, budgeting to most likely costs, and budgeting for inflation.

The fiscal year 1983 defense budget reflects over \$13 billion in savings/cost avoidance accomplished or programmed through FY 1983-1987 resulting from actions to improve the acquisition process. GAO's recommendations, as discussed herein were related to these same general areas i.e., better definition of needs, multiyear contracting, lower cost alternatives, economic production rates, as well as program stability. We could not place an estimate on the savings from these type actions; however, a summary of savings estimated by DOD from these type actions is shown on page 8.

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We have been asked by the Chairman, Senate Armed Services, to evaluate these savings. An initial report has been issued and additional work is underway ^{1/}. In our work to date, we concentrated on assessing the reasonableness of the actions being taken and looking for indications that the savings estimates were either grossly overstated or understated. Even though we saw no evidence of grossly overstated or understated savings, we cannot express an overall opinion on the accuracy of the reported economies and efficiencies. This is particularly so in that DOD, even now, continues to refine its earlier savings projections and to examine other initiatives and programs for additional savings.

Observations on OMB Circular A-109

We reported that DOD components were not placing enough effort into analyzing their mission and determining their needs, particularly with regard to joint service efforts.

Your December 2, 1981, letter pointed out that DOD recognized the need to better delineate missions among the services and has completely revised the mission area structure for research, development, and acquisition. More recently Defense has eliminated the Mission Element Need Statement (MENS) required by OMB Circular A-109 on Major System Acquisitions replacing it with the Justification for Major System New Starts (JMSNS). No specific comments were provided on efforts to promote joint service efforts.

It is unclear to GAO at this time what affect these actions may have on the acquisition process. We are concerned that such actions may be interpreted as a reversal from prior efforts to place emphasis on "missions". We plan to pay particular attention to DOD actions during the immediate future.

8. Multivear contracting

GAO has supported the multiyear contract concept when applied to carefully chosen candidate programs and where its use will result in program stability and real, achievable savings.

The DOD has advised the Congress of its intent to initiate 13 major multiyear contracts in FY 1983 and estimates savings of \$896 million on 12 of the contracts (one program's savings have not been estimated) across the term of the contracts.

^{1/}Estimated Savings Reported by the Department of Defense

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We have been asked by the Chairman, Senate Armed Services Committee and the Chairman, House Appropriations Committee to examine the validity of these projected savings. An initial report has been issued and additional work will be conducted to monitor Defense's multiyear contracting efforts ^{2/}. Our primary concern is that the reasonableness of the claimed savings cannot be determined because (1) they are based on budgetary estimates rather than contractor proposals and (2) DOD, in calculating savings, did not follow Office of Management and Budget Circular A-94 which directs the use of present value discounting techniques in such decisions.

9. Lower cost alternatives should be examined

DOD said it most assuredly supports the GAO call for examination of lower cost alternatives before approving new items. They said they are placing a much greater emphasis on this front-end planning than has been done in the past and that their 32 initiatives for overhauling the acquisition process particularly focus on examining lower cost alternatives in the concept exploration phase.

Dollar savings resulting from examination of lower cost alternatives were not identified by DOD in its December 2, 1981, letter to GAO. However, the FY 83 Defense budget cited acquisition savings of \$1.5 billion from procurement of lower cost systems. At this point we have not evaluated these savings.

10. Impediments to reducing the costs of weapon systems

GAO reported that there are numerous factors leading to increased weapon system costs. Our conclusion was that the major effects on cost have resulted from (1) low rates of production due to budget constraints and desires to maintain active production bases as long as possible, (2) absence of price competition between contractors, (3) lack of real motivation on the part of contractors to reduce costs, and (4) the impact of socioeconomic programs, Government controls, and red tape.

We also said new leadership is required to make further progress in these areas and expressed hope that the new Under

^{2/}GAO Analysis of Projects Proposed by the Department of Defense for Multiyear Contracting in its Fiscal Year 1983 Budget Request (PT.RD-82-72) April 29, 1982.

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Secretary of Research and Engineering, in concert with the Administrator, Office of Federal Procurement Policy, will press vigorously ahead on these long overdue reassessments of systems acquisition policies.

The DOD, in its December 2, 1981 letter, stated that numerous efforts have been initiated to reduce the costs of weapon systems. They said that they have

--proposed several legislative initiatives to revise various regulations pertaining to socioeconomic programs which adversely affect weapon systems and other program costs and have

--increased production rates on selected systems in accordance with affordability and priority considerations.

DOD also agrees that a means must be found to insure the existence of a responsive Defense Industrial Base. The Undersecretary of Defense (Research and Evaluation) has been instructed to take the lead to develop concrete proposals to this end, including consideration of an interagency working group to further define span of control and determine organizational relationships and responsibilities.

In summary, DOD said it will take some time for the full effects of these initiatives to be felt in their weapon system funding requirements. However, taken together, they are confident that very significant savings will result from these improvements.

The extent of such savings was shown in DOD's FY 1983 budget submission. Their summary follows:

(\$Millions)

	<u>FY 1981</u>	<u>FY 1982</u>	<u>Projected FY 1983-1987</u>
Eliminate/Reduce Marginal Systems	12	292	6,207
Multiyear Contracting	15	20	1,080
Economic Production Rates	29	472	2,279
Productivity Enhancements	-8	34	323
Other Acquisition Improvements	121	523	3,902
	<u>\$169</u>	<u>\$1,341</u>	<u>\$13,791</u>

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MILITARY MANPOWER ISSUES

Five manpower issues were raised in the January 21, 1981, "proposed agenda." Of these, three are not discussed herein.

The issue of listed force composition is evolving so rapidly that we believe it can be addressed better through a series of service-unique reviews.

The issue of Reserve Forces management continues to be of concern, but we believe that monitoring of ongoing service programs and service-specific reviews will provide a better assessment than continuing the overview policy discussion.

The issue of using more civilians in morale, welfare, and recreation activities has been and continues to be adequately addressed by the services.

The two major unresc'ed manpower issues concern

- the military compensation system and the need for a more cost-effective pay structure and
- the military retirement system and its financial soundness.

The March 6, 1981, interim response to the proposed "agenda" stated that DOD would be "taking a vigorous look not only at the 15 general agenda items * * *, but also at the 26 individual audit reports you cited in support of the agenda." It is clear from the Secretary's December 2, 1981, response that DOD has considered each of the recommendations in the individual reports cited in the "agenda," adopting some, in whole or in part, and disagreeing with others. However, it is also clear that while DOD may be concerned about the fundamental issues underlying the pay and retirement agenda items, it has not adequately acted on them.

During the past several years there has been a growing body of opinion among individuals and groups concerned with military manpower and compensation issues supporting the need for fundamental changes in the pay and retirement systems. Among those calling for a more cost-effective and mission-supportive compensation system have been the Office of Management and Budget, the Brookings Institution, the Rand Corporation, the President's Commission on Military Compensation, the Defense Manpower Commission, various congressional members, and others. Despite this growing body of evidence that fundamental changes are needed, both DOD and the services have been very slow to recognize that the current compensation structure is not the most cost-effective or mission-supportive system, and that a restructured compensation approach would better serve our national defense needs.

11. Military pay reform

The primary purpose of the military compensation package is to enable the Armed Forces to compete with other employers for the personnel they need. There is little debate over this. Instead, the debate centers on whether the traditional high-cost approach of treating all service members alike--the "across-the-board" approach--or the more cost-effective approach of structuring pay by occupation--the "targeting" approach--would better enable the services to compete for the people they need. We have testified on several occasions that, in our opinion, the costly and inefficient "across-the-board" approach can no longer be justified.

Military manpower problems differ substantially by service, grade, assignment location, and especially by occupation. However, problems can generally be categorized as (1) shortages in occupations which require highly marketable skills, (2) shortages in occupations which do not require highly marketable technical skills, but are generally unattractive for whatever reason, and (3) easy to fill occupations which are generally neither technical nor considered "dirty jobs" and are in a surplus position. At the present time, over 60 percent of all military occupations are either over- or under-manned by at least 10 percent. Evidence indicates that the current pay system will merely perpetuate these problems. Some members will continue to be paid far more than is necessary to attract and retain them in their occupations, and others will not be paid enough. To combat the imbalance problems which inevitably result from this inefficient system, the services will continue to ask for other inefficient and costly special and incentive pays, bonuses, and GI Bills.

During the next several years, when Defense spending is projected to reach unprecedented levels while at the same time social programs are being drastically cut, a wasteful compensation philosophy can no longer be justified. As we have stated in testimony and reports over the past year, ^{1/} we believe the time

^{1/}Testimony before the House and Senate Committees on Budget on across-the-board pay raises and other military manpower issues (Mar. 10 and 31, 1981).

Testimony before the Subcommittee on Manpower and Personnel, Senate Committee on Armed Services, on military pay raises and other manpower management issues (May 8, 1981).

Testimony before the Subcommittee on Defense, House Committee on Appropriations, on the proposed 14.3 percent military pay raise (June 1, 1981).

"The Cost Effectiveness of an Education Assistance Program (GI Bill) as a Recruiting Incentive is Unknown" (FPCD-82-12, Jan. 26, 1982).

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has come to end the pay policies and practices which are not only very costly in terms of current and future budget outlays, but which have also proven to be inefficient in addressing current and anticipated manpower problems. While all the answers have not yet been developed as to how a more cost-effective targeted pay system should be designed, we would urge that the Secretary of Defense exert leadership in this area to bring about substantive and fundamental change in the pay structure.

12. Military retirement reform

DOD acknowledges that the military retirement system is a prime target for budget-cutting because of its enormous cost. It cautions, however, that in looking at military retirement it is important to make the distinction between (1) the retirement system itself and (2) the retired pay it produces. We agree with DOD on this point. Where we differ is over the question of whether the current retirement system appropriately supports Defense's manpower requirements. We believe that it does not, and that it causes people to make decisions regarding their career plans which are not always in the best interest of the services. For example, because there is no retirement vesting until members have served 20 years, and no severance payments to enlisted members who leave earlier, the retirement system causes some to stay in the service longer than they are really needed--simply so they can collect retirement--and others to leave earlier than they might otherwise if retirement were vested earlier or if severance pay were available. In our opinion, the structure of the current retirement system is contributing to the shortages of mid-level noncommissioned officers being experienced by the services.

We are encouraged by the Secretary's commitment to take a hard look at the entire military retirement system as part of the next Quadrennial Review of Military Compensation scheduled to begin later this year. We recognize that fundamental retirement system changes cannot be made in isolation without considering how such changes might impact on other manpower and force structure policies. Because of this, it may be necessary to implement substantive retirement system changes in a time-phased sequence to avoid the possible debilitating affect of abrupt changes. Nevertheless, we believe that the time to begin this process of change is long overdue, and we are highly supportive of the Secretary's commitment. We will be monitoring the progress of this effort and are hopeful that the review will bring about retirement system reforms, not only to make it more cost effective, but also to make it more supportive of the required force composition.

While we believe that any substantive reform of the retirement system must be done in concert with other fundamental change in the way DOD pays and manages its people, there are

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system to make it more cost-effective and equitable without degrading the military mission. These include (1) eliminating both the 1-year and the multiyear "look-back" provisions, (2) eliminating the costly and unnecessary recomputation and longevity increase provisions unique to Reserve retirement, and (3) adopting actuarial methods for cost computation and funding procedures that reflect the full cost of accruing retirement benefits. The current pay-as-you-go retirement system now has an unfunded liability in excess of \$431 billion--almost twice the size of the total fiscal year 1983 defense budget. The total cost of retirement needs to be recognized as it accrues in order to (1) measure the total cost of each services' operations, (2) evaluate the long-term effect of changes in benefits, and (3) make useful cost/benefit analyses of various manpower composition alternatives.

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